

Internal Revenue Service, Treasury

§ 1.904(b)-3

Step (4) Under paragraph (a)(3)(i) of this section, the taxable income from sources without the United States is reduced by the amount by which the net capital loss allocable or apportionable to sources without the United States reduces capital gains (long and short-term) from sources within the United States when computing capital gain net income. This is determined by first computing the net capital loss allocable or apportionable to sources without the United States (\$700,000) and the capital gain net income from sources within the United States (\$800,000). In this case, \$700,000 of net capital loss allocable or apportionable to sources without the United States reduces \$700,000 of long and short-term capital gain in computing capital gain net income.

Step (5) Under paragraph (a)(3)(ii) of this section, the adjustment under paragraph

(a)(3)(i) of this section is reduced by an amount equal to the difference between net capital gain from sources within the United States and net capital gain (from all sources), multiplied by the percentage specified under section 1202(a). In this case, the net capital gain from sources within the United States is \$700,000 the net capital gain is \$100,000 and the percentage specified under section 1202(a) is 0.60.

Step (6) Computation of foreign tax credit limitation fraction.

(i) Taxable income from sources without the United States is as follows:

Foreign income (exclusive of capital gains and losses)+Foreign source capital gain net income – 0.60 (foreign source net capital gain) – (paragraph (a)(3)(i) adjustment – paragraph (a)(3)(ii) adjustment)

$$\$2,000,000 + 0 - 0 - \$700,000 + 0.60 (\$600,000) (\$360,000) = \$1,660,000$$

(ii) The entire taxable income is as follows:

Taxable income (exclusive of capital gains and losses)+Capital gains net income – 0.60(net capital gain)

$$\$5,000,000 + \$100,000 - \$60,000 = \$5,040,000$$

Note that no adjustment under paragraph (a)(3) of this section is made with respect to the denominator.

[T.D. 7914, 48 FR 44523, Sept. 29, 1983]

§ 1.904(b)-3 Sale of personal property.

(a) *General rule.* For purposes of section 904 and the regulations thereunder, there shall be included as gain from sources within the United States any gain from sources without the United States arising from the sale or exchange of a capital asset which is personal property (as defined in § 1.1245-3(b)). For purposes of this paragraph, gain from the sale or exchange of a capital asset shall include net section 1231 gain, but shall not include gain from the sale or exchange of a capital asset which is not treated as capital gain. However, gains and losses which are not from the sale or exchange of capital assets but which are treated as capital gains and losses under the Internal Revenue Code are included. The special source rules provided under this section shall be applied on an item by item basis with respect to the sale of personal property

within any taxable year, except that if substantially all the assets of a trade or business (within the meaning of section 368(a)(1)(C)) are sold within any one country within any taxable year, the gains and losses from such sales of such assets shall be netted before applying the source rules under this section.

(b) *Special rules.* Paragraph (a) of this section shall not apply in each of the following cases:

(1) In the case of an individual, if the property is sold or exchanged within the country or possession of the individual's residence.

(2) In the case of a corporation if the property is stock in a second corporation, and is sold in a country or possession in which the second corporation derived more than 50 percent of its gross income for the 3-year period ending with the close of such second corporation's taxable year immediately preceding the year during which the sale or exchange occurred (or for such part of such period as the corporation has been in existence, but in no event less than a 12-month period). For purposes of this paragraph (b)(2) of this section the gross income of any foreign corporation shall be computed in the same manner as if the foreign corporation were a domestic corporation.

Thus, the gross income of a foreign corporation for this purpose includes income from all sources, which is not specifically excluded from gross income under any other provisions of the Code.

(3) In the case of any taxpayer, if the property is personal property (other than stock in a corporation) which is sold or exchanged in a country or possession in which the property is used in a trade or business of the taxpayer, or in which the taxpayer derived more than 50 percent of its gross income for the 3-year period ending with the close of its taxable year immediately preceding the year during which the sale or exchange occurred (or, in case of a taxpayer other than an individual, for such part of such period as the taxpayer has been in existence, but in no event less than a 12-month period). In the case of property sold or exchanged by a partnership, trust, or estate, the determination required by the preceding sentence shall be made at the level of the partnership, trust (other than a grantor trust), or estate. For purposes of this paragraph (b)(3) of this section, the gross income of any foreign corporation (or other entity) shall be computed in the same manner as if the foreign corporation were a domestic corporation (or a domestic entity).

(c) *Exception.* Paragraph (a) of this section shall not apply to a sale of personal property if the gain (determined under chapter 1 of the Internal Revenue Code and computed on an item by item basis as provided under paragraph (a) of this section) from the sale or exchange of the personal property is subject to an income, war profits, or excess profits tax (including a tax withheld with respect to nonresident aliens or foreign corporations) with respect to a foreign country or a possession of the United States in which the sale or exchange occurs, and the rate of tax imposed by such country or possession applicable to such gain is 10 percent or more. For purposes of this paragraph, the tax must be 10 percent or more of the total amount of gain (whether ordinary or capital) arising from the sale or exchange of the item of personal property.

(d) *Application of source rules.* In determining the foreign country or pos-

session where property is sold or exchanged for purposes of paragraphs (b) and (c) of this section, and the foreign country or possession where gross income is derived for purposes of paragraphs (b)(2), (3) and (e) of this section, the source of any gain or income shall be determined by applying the principles under sections 861, 862, and 863 and the regulations thereunder.

(e) *Gain from liquidation of certain foreign corporations.* Paragraph (a) shall not apply with respect to a distribution in liquidation of a foreign corporation to which part II of subchapter C applies, if such corporation derived less than 50 percent of its gross income from sources within the United States for the 3-year period ending with the close of such corporation's taxable year immediately preceding the year during which the distribution occurred (or for such part of such period as the corporation has been in existence, but in no event less than a 12-month period). For purposes of paragraph (e) of this section, the gross income of the foreign corporation shall be computed in the same manner as if the foreign corporation were a domestic corporation.

(f) *Residence defined.* For purposes of paragraph (b)(1) of this section, the country of an individual's residence is to be determined by applying the rules under §§ 301.7701(b)-1 through 301.7701(b)-9 of this chapter.

(g) *Tax rate applicable to gain.* For purposes of paragraph (c) of this section, the tax rate applicable to the gain on the sale or exchange of personal property (as determined under chapter 1 of the Internal Revenue Code 1954) shall be determined by applying the tax laws of the foreign country or possession (and any applicable reduction under a tax treaty) to such gain and by treating the gain from such transaction as if such gain were the only income derived by the taxpayer during the taxable year (and the only deductions allowed are deductions directly attributable to such gain).

(h) *Country in which gross income derived.* Notwithstanding paragraph (d) of this section, for purposes of this section, dividends received by a shareholder who is not a U.S. person from a foreign corporation shall be deemed to

Internal Revenue Service, Treasury

§ 1.904(f)-1

be derived from sources within the foreign country under the laws of which the foreign corporation is created or organized.

[T.D. 7914, 48 FR 44524, Sept. 29, 1983, as amended by T.D. 8411, 57 FR 15241, Apr. 27, 1992]

§ 1.904(b)-4 Effective date.

Sections 1.904(b)-(1) and 1.904(b)-2 shall apply to taxable years beginning after December 31, 1975 and § 1.904(b)-3 shall apply to sales and exchanges made after November 12, 1975.

[T.D. 7914, 48 FR 44525, Sept. 29, 1983]

§ 1.904(f)-1 Overall foreign loss and the overall foreign loss account.

(a) *Overview of regulations.* In general, section 904(f) and these regulations apply to any taxpayer that sustains an overall foreign loss (as defined in paragraph (c)(1) of this section) in a taxable year beginning after December 31, 1975. For taxable years ending after December 31, 1984, and beginning before January 1, 1987, there can be five types of overall foreign losses: a loss under each of the five separate limitations contained in former section 904(d)(1)(A) (passive interest limitation), (d)(1)(B) (DISC dividend limitation), (d)(1)(C) (foreign trade income limitation), (d)(1)(D) (foreign sales corporation (FSC) distributions limitation), and (d)(1)(E) (general limitation). For taxable years beginning after December 31, 1982, and ending before January 1, 1985, there can be three types of overall foreign losses under former section 904(d)(1)(A) (passive interest limitation), former section 904(d)(1)(B) (DISC dividend limitation) and former section 904(d)(1)(C) (general limitation). For taxpayers subject to section 907, the post-1982 general limitation overall foreign loss account may be further subdivided, as provided in § 1.904(f)-6. For taxable years beginning after December 31, 1975, and before January 1, 1983, taxpayers should have computed overall foreign losses separately under the passive interest limitation, the DISC dividend limitation, the general limitation, and the section 907(b) (FORI) limitation. However, for taxable years beginning after December 31, 1975, and before January 1, 1983, taxpayers may

have computed only two types of overall foreign losses: A foreign oil related loss under the FORI limitation and an overall foreign loss computed on a combined basis for the passive interest limitation, the DISC dividend limitation, and the general limitation. A taxpayer that computed overall foreign losses for these years on a combined basis will not be required to amend its return to recompute such losses on a separate basis. If a taxpayer computed its overall foreign losses for these years separately under the passive interest limitation, the DISC dividend limitation, and the general limitation, on returns previously filed, a taxpayer may not amend those returns to compute such overall foreign losses on a combined basis. Section 1.904(f)-1 provides rules for determining a taxpayer's overall foreign losses, for establishing overall foreign loss accounts, and for making additions to and reductions of such accounts for purposes of section 904(f). Section 1.904(f)-2 provides rules for recapturing the balance in any overall foreign loss account under the general recapture rule of section 904(f)(1) and under the special recapture rule of section 904(f)(3) when the taxpayer disposes of property used predominantly outside the United States in a trade or business. Section 1.904(f)-3 provides rules for allocating overall foreign losses that are part of net operating losses or net capital losses to foreign source income in years to which such losses are carried. In addition, § 1.904(f)-3 provides transition rules for the treatment of net operating losses incurred in taxable years beginning after December 31, 1982, and carried back to taxable years beginning before January 1, 1983, and of net operating losses incurred in taxable years beginning before January 1, 1983, and carried forward to taxable years beginning after December 31, 1982. Section 1.904(f)-4 provides rules for recapture out of an accumulation distribution of a foreign trust. Section 1.904(f)-5 provides rules for recapture of overall foreign losses of domestic trusts. Section 1.904(f)-6 provides a transition rule for recapturing a taxpayer's pre-1983 overall foreign losses under the general limitation and the FORI limitation out